



# Oklahoma Economic Report™

News and analysis of Oklahoma's economy

A publication of the Office of the State Treasurer • Treasurer Ken Miller, Ph.D.

## Tax reform brewing

The key public policy debate during this interim has been about taxes: credits, incentives, rates and reform. Three task forces have been addressing various components of Oklahoma tax law.

A clear objective emerging from the panels is to chart a course toward reducing and possibly eliminating Oklahoma's personal income tax.

In January, Governor Mary Fallin assembled the Task Force on Economic Development and Job Creation. The group's final report, issued on September 19, contained recommendations on 13 topics ranging

from eliminating business regulations to enhancing the state's image to restructuring the tax system.

True to the title of the report, *Bold Ideas for Oklahoma*, the centerpiece recommendation from the taxation subcommittee is to "initiate a 10-year program to significantly reduce then ultimately eliminate the Oklahoma personal income tax."

The topic of reducing the state income tax is nothing new for panel member Howard Barnett, who served as chief of staff for Governor Frank Keating.

"In 2002, my last year as chief of staff for Governor Keating, there was broad agreement among some of the most liberal and most conservative in the Legislature that a plan to extend sales taxes to certain services to significantly lower income tax rates was good economic policy for the State of Oklahoma. I believe it still is," Barnett said.

Another panel, the Task Force on Comprehensive Tax Reform, began its work on September 15 in Oklahoma City. It met again on October 20 in Tulsa. A key goal of the 21-member group is to recommend simplification of the Oklahoma tax code and to lower overall rates.

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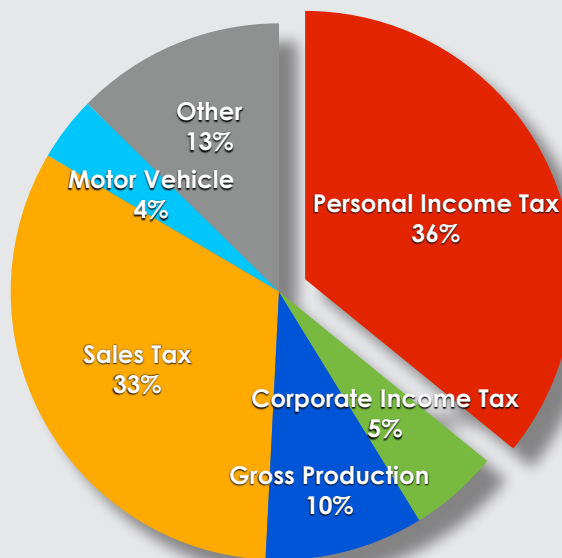
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### Composition of Oklahoma General Revenue Fund



#### Fiscal Year 2011 (in millions)

Personal Income Tax	\$1,832.1
Corporate Income Tax	\$274.3
Gross Production	\$488.5
Sales Tax	\$1,668.3
Motor Vehicle	\$198.6
Other	\$676.2
Total	\$5,138.0

Source: Office of State Finance



## Governor's Commentary By Governor Mary Fallin

### More than OK:

*Oklahoma's economy shows remarkable strength during Great Recession*

Since the beginning of the Great Recession, there have been few governors who have been able to boast of strong economic performances in their states. I am happy to be one of them.

While the national economy is still weak, with an unemployment rate of over 9% and stagnant growth, Oklahoma is moving forward at a steady pace.

Our seasonally-adjusted unemployment rate now stands at an enviable 5.9%, down from a high of 7.3% in March 2010. Meanwhile, I am proud to say that Oklahoma has created 43,100 new jobs and growing in the past year.

In this globally challenging economic climate, these gains are nothing short of remarkable.

The reasons for Oklahoma's success are numerous, and some of them are long-standing advantages. We have a low cost of living, an abundance of natural resources like oil and natural gas, and a number of military bases that provide good jobs to our local communities.

These are all great things for Oklahoma, and they'll continue to be

an asset for many years as we work to retain and lure more jobs and businesses to the state.

Equally important, however, is our pro-business climate. With conservative lawmakers occupying the governor's office, both houses of the legislature and every statewide office, we set about to make 2011 a landmark year for pro-business, pro-jobs reform.

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**“... exciting things are happening in Oklahoma and people are taking notice.”**

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Lawmakers succeeded in sending to my desk a series of bills designed to make Oklahoma a more attractive place to do business. These measures included comprehensive lawsuit reform, a rewrite of the state's costly and outdated workers compensation laws, job-creating tax incentives in the aerospace industry, improvements to common education and a series of modernization efforts that will make government more efficient and effective for years to come.



Additionally, we have announced initiatives to dramatically increase the number of college graduates in Oklahoma and to all but eliminate structurally deficient highway bridges in the state by 2019. And for good measure, we even cut our income taxes!

All of these reforms and initiatives add up to a concerted effort to demonstrate that Oklahoma is “open for business.” Small business owners in Oklahoma and elsewhere now see a state that is committed to reducing cost drivers like costly workers compensation fees and frivolous lawsuits.

They see a state that is committed to improving the quality of its workforce and the educational institutions that train them; a place where taxes are low and the government lives within its means; and a place that is on course to move from one of the worst states in the country for highway bridges to one of the top five.

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## Governor

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In other words, exciting things are happening in Oklahoma, and people are taking notice. I believe the results will continue to be an influx of more and better jobs and an increase in prosperity.

Moving forward, it's important to continue to build on Oklahoma's momentum. That means continuing to make Oklahoma the most business-friendly state possible. It also means implementing and funding the initiatives we have put into place this year while continuing to market Oklahoma as the go-to place to do business in the region and the nation.

It's been a good year for Oklahoma. My goal is for 2012 to be even better!

## Tax reform

### FROM PAGE 1

Former State Treasurer Scott Meacham, now chairman of the State Chamber's Taxation and Economic Development Committee, urged the group to approach the topic very carefully.

"It's always good to reform and simplify taxes, but if tax reform means a redistribution of tax burden to the business sector, it will only serve to harm Oklahoma's economy," he said.

Senator Mike Mazzei, chair of the Senate Finance Committee and co-chair of the reform task force, said, "The primary goal is to eliminate ineffective and obsolete tax giveaways to save millions of dollars that can be used to

lower Oklahoma's income tax rate."

Mazzei said he intends to offer a proposal next session that leads Oklahoma to a "no income tax state."

Governor Fallin said she looks forward to the report from the tax reform task force. "One of my end goals is that we continue to lower our personal income tax in Oklahoma. I also look forward to reviewing the findings of the legislative task force on taxes as we work to remove tax incentives that don't create jobs and investment," she said.

State Treasurer Ken Miller said Oklahoma's current tax policy does not enhance growth.

"If we were to design an equitable and efficient tax code that would encourage entrepreneurial activity, productivity and growth, we would not end up with the tax structure we have today."

And therein lies the challenge – crafting a tax structure that fosters economic growth, is efficient, fair and reasonable, and ensures revenue sufficient to fund core government services.

### Mixed reviews

Lowering and abolishing the state income tax is not without its detractors. David Blatt, director of the Oklahoma Policy Institute, is a vocal advocate for retaining the state income tax and increasing its progressiveness.

Blatt argues that Oklahoma is a low-tax state and questions whether Oklahomans are provided adequate state services with per capita spending below the national average.

Blatt suggests business investment decisions are driven more by the presence of a well-trained, productive workforce and strong public

infrastructure than by state and local tax rates.

In spite of opponents' arguments, it appears public sentiment favors cutting the income tax. In a SoonerPoll survey commissioned by the Oklahoma Council of Public Affairs, a strong majority said they prefer lower taxes, smaller government and fewer services.

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“One of my end goals is that we continue to lower our personal income tax in Oklahoma.”  
– Governor Fallin

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Other polls show people have a negative view of spending in the aggregate, but positively view individual items like education, public safety, transportation infrastructure and health care, which comprise more than 80 percent of state spending.

### Revenue neutrality

Oklahoma political leaders have long discussed eliminating the state's income tax. However, the discussion often focused exclusively on ending the tax without regard to the loss of more than one-third of state revenues or how to replace them.

The September 19 report to the governor acknowledges the income tax is the primary source of revenue for Oklahoma government, representing 36 percent of all revenues accruing to the General Revenue Fund during Fiscal Year 2011.

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## Tax reform

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It cites a 2001 study on eliminating the income tax that offered expanding the state sales tax base, increasing rates on other services, or creating new revenue sources, including a state property tax, as options for replacing revenue.

This panel states: “The challenge in implementing a revenue-neutral shift in tax policy is to offset the loss of a substantial source of revenue while maintaining economic efficiency.”

### Setting the course

In making its case, the task force reports that some of the nine states without an income tax have seen higher rates of economic development than Oklahoma in recent years and that, “phasing out the income tax will provide a substantially greater economic climate for both individuals and businesses.”

The task force lists three steps to implement a revenue-neutral change:

- Set a schedule of reducing the income tax rate to zero over a seven to 10-year period;
- Eliminate credits and exemptions along the way to help offset the revenue reductions; and,
- Find new revenue sources.

The report says setting a long-term schedule of reducing the income tax rate will provide a stable environment to encourage economic development and attract new businesses. Elimination of credits and exemptions would allow for the overall tax rate to be reduced with minimized loss of revenue.

The panel projects a 10-year phase-out, coupled with cutting tax credits, would

require finding approximately \$243.4 million in additional revenue each year.

The report offers four options for possible replacement revenue: sales tax on services, implementation of the Texas Model – including a state property tax, phasing out the tax with no additional revenue, and combinations of all.

Extending the sales tax to services, according to the report, would generate almost \$94 million. The figure is arrived at by adjusting for inflation figures originally cited in a 2002 task force on eliminating the income tax spearheaded by then-Governor Frank Keating.

The Texas tax system of no income tax and substantially higher property taxes, the report says, is a “significant

contributor” to the recent success Texas has experienced, including the creation of 265,000 jobs since the summer of 2009. Instituting a state property tax 28 percent lower than that of Texas could provide enough money to replace Oklahoma’s income tax, the report states.

The report also offers an option of phasing out the income tax without finding replacement sources of revenue by cutting state government spending by \$243.4 million each year for 10 years.

While the discussion may not be new, the political climate has changed considerably. With fiscal conservatives now dominating state government, tax reform is more likely than ever before.

### Income Taxes versus Growth

#### Regional

#### State Income Tax Rates

New Mexico	4.90%
<b>Oklahoma</b>	<b>5.50</b>
Arkansas	7.00
Kansas	6.45
Texas	none
Missouri	6.00
Colorado	4.63

#### Per Capita Income Growth 2000-2010

18.77%
<b>18.27</b>
17.39
11.55
10.50
6.07
0.51

#### Oklahoma vs. States with no income tax

#### State & Local Tax Burden (Percentage of income)

Wyoming	7.8%
<b>Oklahoma</b>	<b>8.7</b>
South Dakota	7.6
Alaska	6.3
Texas	7.9
Florida	9.2
Washington	9.3
Tennessee	7.6
New Hampshire	8.0
Nevada	7.5

#### Per Capita Income Growth 2000-2010

30.74%
<b>18.27</b>
17.48
12.84
10.50
7.94
7.39
5.77
3.57
-4.48

Notes: State income tax figures based on top tax rate as of January 1, 2011. Per Capita Income Growth are real numbers adjusted for inflation.

Sources: The Tax Foundation, U.S. BEA, Michigan Department of Technology, Management and Budget



## September gross receipts & General Revenue Fund

A comparison of the Treasurer's October 4 Revenue Report and State Finance's October 10 General Revenue Fund (GRF) allocation report illustrates key differences.

September gross receipts totaled \$960.4 million, while the GRF received \$526.2 million or 54.8 percent of the total. In August, the GRF received 49.2 percent of the gross.

The differences are due to variances in the transfer of funds for rebates and dedicated funding.

In September, the GRF received:

- 76.2 percent of personal income tax
- 64.9 percent of corporate income tax
- 44.5 percent of sales tax receipts
- 80.3 percent of the gross production (GP) tax on natural gas
- No GP oil tax revenue of \$50.8 million collected.
- 32.4 percent of motor vehicle tax collections
- 54 percent of other revenue sources

Tribal gaming fees generated \$10.4 million during the month.

Insurance premium taxes generated \$33.7 million in September.

Treasurer Miller says external threats to economy were "kept at bay"

## Oklahoma economy shows steady growth in September

More than 18 months after revenues began climbing from the depths of the Great Recession, the Oklahoma economy is again showing steady growth across all sectors, State Treasurer Ken Miller said as he released the state's gross revenue report for September.

Collections were 7.1 percent higher than in September of last year, a more moderate growth rate than what was recorded in June and August of this year when year-over-year growth topped 15 percent each month.

Miller said collections over the past 12 months total \$10.43 billion, the highest level in 27 months when 12-month collections in June 2009 totaled \$10.57 billion.

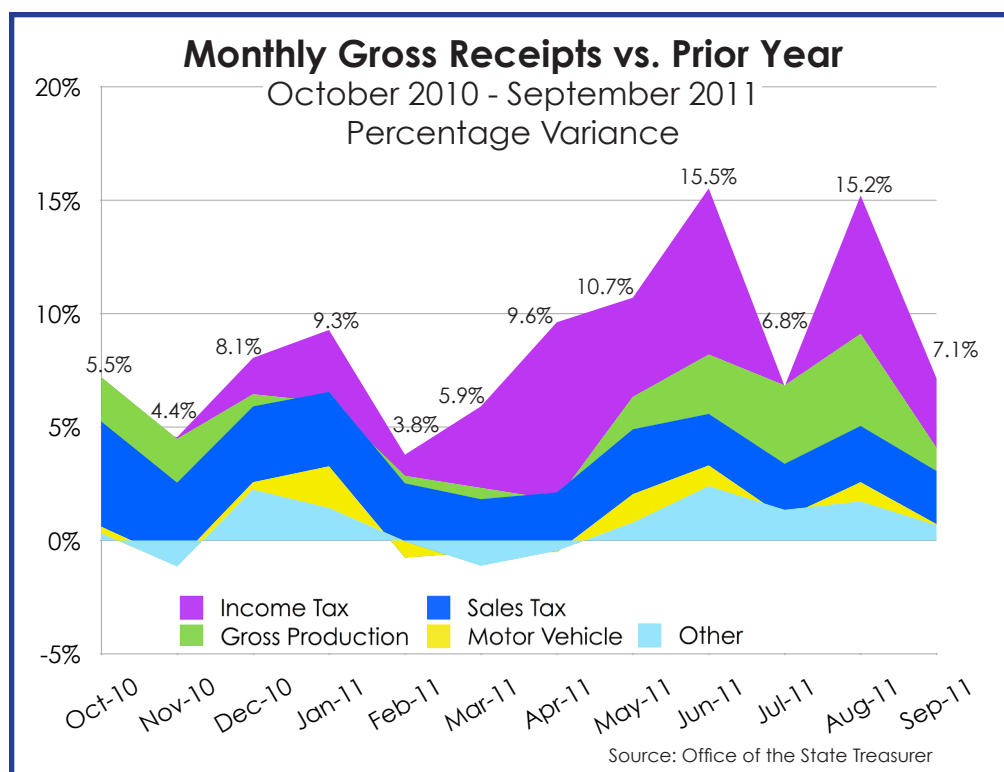
### It's a good thing

Miller said September's report shows continued economic recovery in Oklahoma.

"Healthy increases in all revenue streams show the state's economy is still healing nicely from the recession," he said. "Basically this report shows more of the same, which is a good thing. It means Oklahoma's economy continues on a positive trajectory and external threats to our well-being have been kept at bay."

Miller said the moderation in rate of growth from the prior year is not unexpected or of concern.

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## Revenue

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“While growth topped 15 percent in two of the last four months, September’s 7.1 percent increase over the same month of last year is still encouraging,” he said.

“We can’t expect to see double-digit growth on an ongoing basis, but absent a second global economic contraction, we have every reason to remain bullish on Oklahoma’s economy. Our fundamentals are strong – corporate profits are good, unemployment is relatively low, banks and real estate prices remain healthy, and state political leadership is cultivating an environment conducive to future growth.”

September reports show the national unemployment rate held steady at 9.1

percent, while Oklahoma’s seasonally-adjusted unemployment rate rose from the prior month by 0.3 percent to 5.9 percent. That is one percent lower than in September of last year.

Miller said the new state unemployment rate is likely a sign of economic improvement. “The slight uptick can be interpreted as a sign of recovery and renewed optimism for employment prospects as formerly discouraged job seekers reentered the labor force,” he said.

Last month 7,920 Oklahomans began looking for employment and 3,240 were successful in obtaining a job.

Also as expected, collections of gross production taxes on oil and natural gas are showing signs of moderation. Last month, that revenue source was up more

“... absent a second global economic contraction, we have every reason to remain bullish on Oklahoma’s economy.”

than 40 percent from the prior year. This month, gross production collections are above the prior year by close to 12 percent.

## First quarter general revenue exceeds estimate

Reports issued by the Office of State Finance show allocations to the General Revenue Fund (GRF) for the first quarter of Fiscal Year 2012 are higher than the estimate.

GRF allocations for the July-September period total \$1.323 billion, which is \$87.9 million or 7.1 percent higher than the estimate.

Net income taxes, a combination of personal and corporate income taxes less transfers and refunds, total \$551.9 million and top the estimate by \$78.3 million or 16.5 percent.

Sales taxes produced \$444.1 million for the period, exceeding the estimate by \$5.3 million or 1.2 percent.

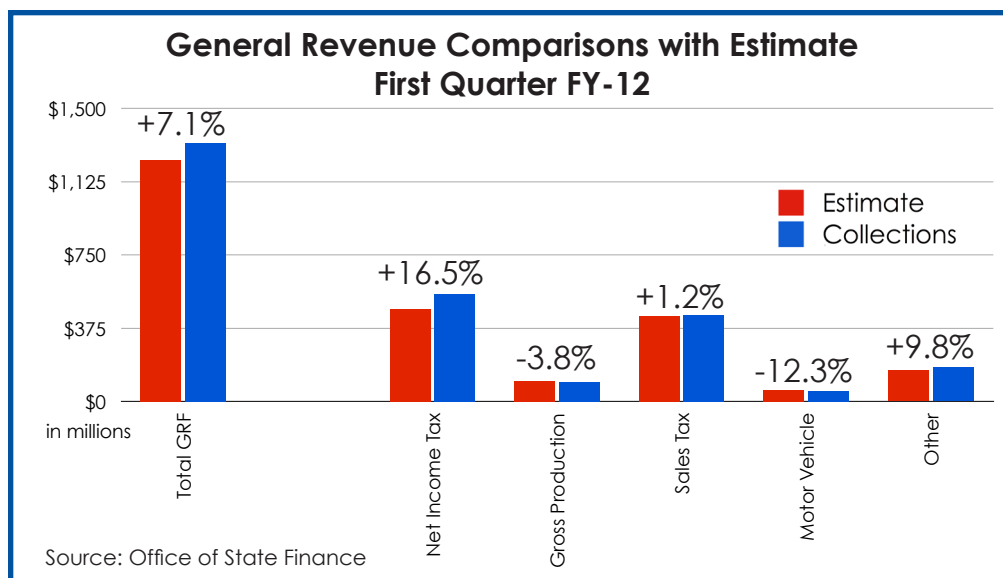
The gross production tax on natural gas generated \$100.3 million for the GRF

during the quarter. This is \$4 million or 3.8 percent below the estimate.

Motor vehicle tax contributions to GR total \$52.3 million, which fell below the

estimate by \$7.4 million or 12.3 percent.

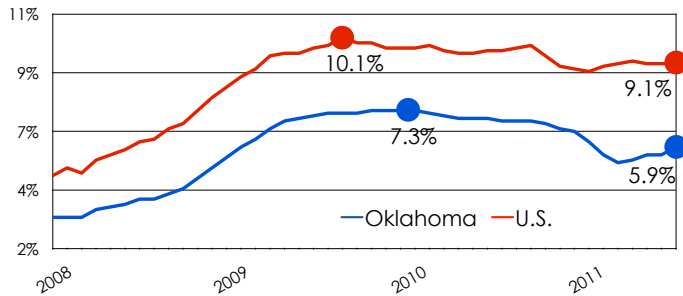
Other sources brought \$175.1 million to the GRF, which is \$15.7 million or 9.8 percent higher than the estimate.





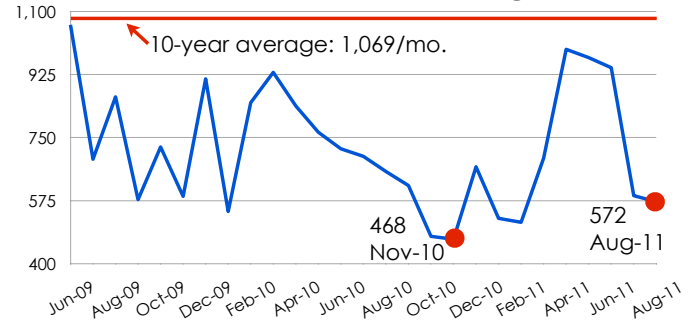
## Economic Indicators

### Unemployment Rate U.S. vs. Oklahoma



Source: Bureau of Labor Statistics

### Oklahoma Residential Building Permits



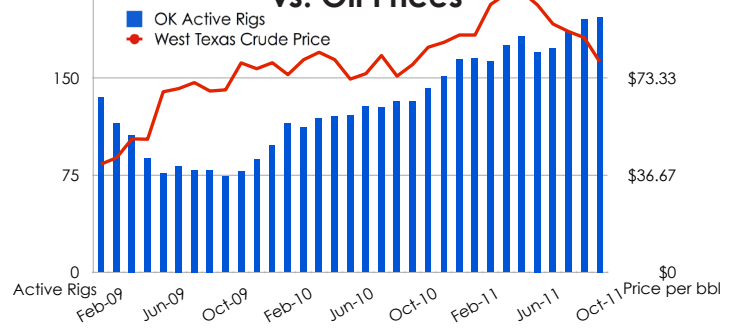
Source: Department of Commerce, Bureau of Census

### Oklahoma Stock Index (Top 25 capitalized companies)



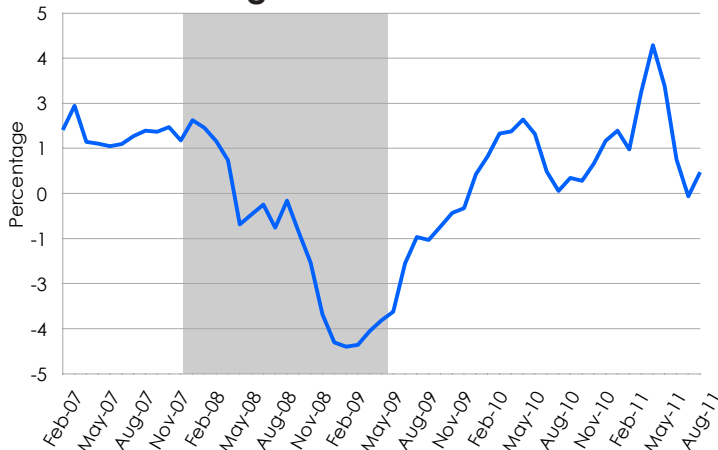
Source: Office of the State Treasurer, Budget & Finance Division

### Oklahoma Active Rigs vs. Oil Prices



Source: Baker Hughes & U.S. Energy Information Administration

### Leading Index for Oklahoma



Source: Federal Reserve Bank

### Interest Rate Forecast

68 Economists

	4Q 2011	1Q 2012	2Q 2012	3Q 2012	4Q 2012	1Q 2013
<b>Fed Funds Target</b>	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
3-M LIBOR	0.35%	0.36%	0.34%	0.34%	0.35%	0.40%
<b>Treasury Notes</b>						
2-Year	0.25%	0.30%	0.40%	0.45%	0.50%	0.62%
10-Year	2.10%	2.21%	2.40%	2.50%	2.75%	2.78%
<b>Treasury Bonds</b>						
30-Year	3.20%	3.28%	3.50%	3.63%	3.85%	3.99%
<b>Economic Indicators</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>			
Real GDP	1.70%	2.00%	2.45%			
Unemployment	9.10%	8.90%	8.40%			

Source: Media forecasts for key economic indicators as surveyed by Bloomberg, October 17, 2011